Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	John Campbell	Analyst:	LuAnna Hass	Bill Number:	ACA 6
Related Bills:	See Legislative History	Telephone:	845-7478	Introduced Date:	January 8, 2003
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Expenditures Limit/Issuance Of Rebates

SUMMARY

This constitutional amendment generally would require the Franchise Tax Board (FTB) to issue rebates of excess revenues to personal income taxpayers.

This analysis will not address the measure's changes to the other provisions of the California Constitution regarding various appropriations and the State School Fund, as they do not impact the department or state income tax revenue.

PURPOSE OF THE BILL

According to the author's office, the intent of this measure is to revise the General Fund revenue and expenditures laws to level off the spending and revenue to prevent budget surpluses that would be spent and budget deficits that would require cutting back on spending. This would enable the legislature to forecast accurately for the future.

EFFECTIVE/OPERATIVE DATE

This measure would become effective and operative the day following approval by the voters in the next general election, which would be in November 2004, if such approval occurs.

POSITION

Pending.

ANALYSIS

STATE LAW

Under the California Constitution, the voters of the State have the authority to approve or reject any amendments to the State Constitution. Private citizens or groups can initiate amendments or the Legislature may place an amendment on the ballot if the proposal passes each House by a two-thirds vote. The Legislature proposes amendments to the California Constitution by passing a Senate Constitutional Amendment (SCA) or an Assembly Constitutional Amendment (ACA). Neither an SCA nor an ACA require the approval of the Governor. After the Legislature approves an SCA or ACA by two-thirds vote in the Senate and the Assembly, it is assigned a proposition number and placed on a statewide ballot for the voters to approve or reject the proposed change. Any amendment to the Constitution proposed by the Legislature and adopted by a majority vote of the people takes effect the day after its adoption.

Board Position:			Department Director	Date
______ S	______ NA	______ NP	Gerald H. Goldberg	01/31/03
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Currently, specific provisions of Article XIIIB of the California Constitution:

- Prohibits a government entity's annual appropriation from exceeding its annual limit, which is adjusted annually for the cost of living and population changes.
- Provides that:
  - 50% of the excess revenues that are received by the State in a fiscal year, which is in excess of the amount that may be appropriated by the State for that same fiscal year, are transferred to the State School Fund.
  - The remaining 50% of the excess revenues must be returned by the State by revising tax rates or fee schedules within the next two subsequent fiscal years.
- Provides that in the event the financial responsibility of providing a service is transferred, in whole or in part, from one entity of government to another, then the appropriations limit of the transferee entity shall be increased by an amount that both entities agree upon. Additionally, the appropriations limit of the transferor entity shall be decreased by an equivalent amount.

<u>THIS BILL</u>

This measure would repeal and replace Article XIIIB of the California Constitution. Specifically, this measure would include, but is not limited to, the following changes.

- Total General Fund spending in a fiscal year may not increase from the prior fiscal year by more than the percentage increase in the cost of living, as defined in this section, multiplied by the percentage increase in the state population. However, if in the previous fiscal year, total spending was less than that allowed, then the total spending for the next fiscal year would be based on the total allowable spending instead of actual spending of the previous fiscal year. Exceptions would be made for emergencies, as defined in this measure.
- Any revenue that may not be spent in the current fiscal year due to the spending limit above shall be allocated as follows:
  - To the Special Reserve Account within the General Fund so long as this account contains an amount less than or equal to 10% of the total amount of allowable spending for the current fiscal year. Money in the reserve account may be spent subject to the specifications of this measure.
  - Revenue in excess of the 10% allowed for the Special Reserve Account shall be allocated as follows:
    - 50% transferred to the State School Fund.
    - 50% paid as a rebate to all personal income taxpayers. The rebate would be proportionate to the tax liability for the tax year that encompasses the first half of the current fiscal year in which the excess exists.
- To prevent an increase in the level of allowable state spending, if the financial responsibility of providing a service is transferred, in whole or in part, from the state government to a local government, then the total amount of allowable state spending for the year of the transfer shall be reduced by an amount equal to the cost of providing the transferred services.

IMPLEMENTATION CONSIDERATIONS

The Revenue and Taxation Code requires FTB to administer and enforce the income tax laws. This constitutional amendment generally would require FTB to oversee the issuance of rebates since the amount of the rebate is connected to the taxpayer's tax liability on their personal income tax return.

Department staff has identified the following implementation considerations for purposes of a high level discussion; additional concerns may be identified as the measure moves through the legislative process. In order for FTB to implement this measure, clarification is needed for at least the following issues:

- Clarification of the term "proportion." Under this measure, funds must be rebated to California personal income taxpayers in proportion to their tax liability for the tax year that includes the first half of the current fiscal year in which the excess exists. It is unclear what specific criteria or measures FTB would use to determine the proportionate share of rebate for each taxpayer. The following are a few of the questions that should be addressed:
  - Would there be a minimum or maximum rebate amount?
  - Would the phrase "proportion to their tax liability for the tax year" mean that the taxpayer would receive a rebate in proportion to their tax liability in comparison to the total tax liability of all PIT taxpayers for that tax year?
- A timeframe for the issuance of the rebates. This measure provides the rebate is in proportion to the taxpayer's tax liability, but does not specify when the rebates should be issued. Personal income tax returns may be filed, with extension, until October 15. The department generally processes returns within six months of receipt, which means a majority of the tax returns should be processed by April of the following year. In order to calculate rebates proportionate to the tax liability, FTB would need to process all tax returns for the identified tax year prior to calculating the rebate amount to ensure all eligible taxpayers are accounted for. For example, tax returns for the 2002 taxable year may be filed until October 15, 2003, and most of the processing completed by April of 2004. Therefore, if the state has excess revenues for the 2002/2003 fiscal year FTB may be able to begin calculating the rebates in April 2004 based on the 2002 taxable year.
- Provisions of the Internal Revenue Code require reporting of state or local income tax refunds to the IRS. Although the rebate payments are based on funds available from excess state revenues, and not solely derived from excess income taxes paid, it is likely that the rebate would be required to be reported to the IRS as additional income. However, if the rebate were considered a refund of income taxes paid, it also would be required to be reported to the IRS. However, the reporting requirements for the department differ for income and refunds.
- Could rebate payments be revised after issuance? Depending on the factors determining the rebate amount, certain circumstances could result in rebate revisions. These factors include the receipt of amended returns, audit adjustments, or processing errors.
- How will offsets to FTB, the Internal Revenue Service, and other State agencies be handled? Currently, these agencies participate in an agency-offset process where refunds are offset to satisfy an outstanding liability owed by the taxpayer to another government entity. Without clarification this could be construed as either a payment of excess state revenues or a refund of taxes paid. As such, clarification would be needed on whether these payments would be subject to the agency-offset process.

If these concerns and any additional concerns that may be identified are not clarified in this measure, then the department would need future enabling legislation prior to the issuance of the rebates.

In addition, if FTB were responsible for issuing the rebates as proposed by this measure, the department would need to create a new system for issuing and processing the rebates. This measure does not include an appropriation to cover the costs of developing a system for issuing and processing the rebate. Without an appropriation the department would be required to redirect resources from revenue producing activities to implement this measure.

LEGISLATIVE HISTORY

ACA 22 (Campbell, 2001/2002) would have required FTB and the State Controller to issue rebates of a portion of the revenues received by the state in excess of the amount appropriated by the State during the fiscal year. This bill died at the Assembly Desk.

SCA 16 (McClintock, et al., 2001/2002) would have required FTB and the State Controller to issue rebates of any revenues received by the state in excess of the amount appropriated by the State during the fiscal year. This bill failed passage with the Senate Revenue and Taxation Committee.

A version of AB 2869 (Machado, Stats. 2000, Ch. 977) prior to enactment would have authorized a sales and use tax rebate to qualified taxpayers of $50 or a variable amount based on the taxpayer's filing status and federal adjusted gross income. This provision was removed from the bill.

AB 2609 (Stats. 1987, Ch. 915) and SB 47 (Stats. 1987, Ch. 908) authorized a tax rebate of excess funds for the 1986 taxable year. Qualified taxpayers were allowed a tax rebate of 15% of the tax imposed by the income tax law, as defined, with specified minimum dollar limits and maximum dollar limits. The rebate was calculated and administered by FTB and required rebate checks to be sent by the Controller to taxpayers by January 15, 1988.

OTHER STATES' INFORMATION

A review of the state laws and Constitutions of *Florida, Massachusetts, Michigan,* and *Minnesota,* found the following:

- *Florida* and *Minnesota* require excess revenues to be refunded to the taxpayers.
- *Massachusetts* allows a credit, called the "excess revenue credit," toward taxpayers' personal income tax liabilities.
- *Michigan* requires excess revenue to be refunded on a pro rata basis that is based on the liability reported on the Michigan income tax and single business tax returns.

A review of *New York* and *Illinois* state laws and Constitutions did not produce any information regarding procedures for excess revenues. The laws of these states were reviewed because of similarities to California income tax laws.

FISCAL IMPACT

The department's costs to administer this measure cannot be determined until implementation concerns have been resolved but are anticipated to be significant. At a minimum, the department would need to implement a system to calculate and issue the rebates proposed in this measure.

ECONOMIC IMPACT

This measure would not impact personal income tax and corporate tax revenues.

ARGUMENTS/POLICY CONCERNS

Other methods are available to rebate excess State revenue that may be accomplished more efficiently, such as a change in 1) tax rates, 2) taxable income brackets, or 3) the standard deduction.

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